

CALIFORNIA PUBLIC EMPLOYEES' RETIREMENT SYSTEM (CalPERS)

FINANCE COMMITTEE CHARTER

I. STATEMENT OF POLICY

On November 3, 1992, the people of the State of California passed Proposition 162, which amended Article XVI, section 17 of the California Constitution, granting the California Public Employees' Retirement System (CalPERS) Board of Administration (Board) plenary authority over the administration of CalPERS. On December 18, 1992, the Board implemented its plenary authority by adopting Delegation Resolution No: 92-04A to take exclusive control over the administration of the system, including but not limited to adoption of budgets. Furthermore, the Board continues to have full responsibility for the financial oversight of CalPERS.

To fulfill its responsibilities of budgetary control and financial oversight, the Board must ensure that CalPERS maintains: (1) an effective budget formulation, review and approval process; (2) an adequate system of internal controls; (3) adequate safeguards over assets; and (4) effective financial reporting and administration that is in compliance with all applicable laws and regulations.

In addition to its budgetary control and financial oversight, the Board has established a long-range Strategic Plan designed to focus the organization on a set of enterprise goals aimed at meeting the needs and demands of members, employers, and retirees by achieving the System's mission. The Board is responsible for all matters related to the ongoing maintenance of the Strategic Plan and in the approval of the Three-Year Business Plan and Annual Plan that generate specific objectives, outcomes, and projects in support of the enterprise goals. It is the Annual Plan that establishes enterprise budget priorities.

The Finance Committee was established at the February 18, 1993 Board meeting, to assist the Board in meeting these responsibilities and assumed the responsibilities of the former Audit Committee. Effective April 18, 2001 it will also assume the responsibilities of the former Strategic Planning Committee.

II. GENERAL AUTHORITY AND RESPONSIBILITY

The Finance Committee shall have the authority and responsibility to adopt its own operating rules and procedures including the authority to call for assistance from CalPERS' operating staff or to request outside assistance when needed.

III. PURPOSE

The primary function of the Finance Committee is to assist the Board in fulfilling its oversight responsibilities by: overseeing the annual budget process; reviewing financial reports and other financial information provided by CalPERS staff; monitoring CalPERS' internal control system; assuring compliance with pertinent

laws, regulations and Board policies; overseeing CalPERS' financial reporting, auditing, accounting and budget processes and reviewing all matters related to the maintenance and achievement of the Strategic Plan. The Finance Committee's general duties and responsibilities include:

- Serving as an objective and independent party to monitor CalPERS' financial processes and internal control system.
- Reviewing and appraising the audit, assurance and other attest efforts of the Board's independent financial statement auditor and the Board's external real estate compliance auditor.
- Reviewing and appraising the audit and assurance efforts of the internal auditors, and receiving quarterly notices of the consulting activities of the internal auditors.
- Providing an open avenue of communication among the independent financial statement accountant, the independent real estate compliance auditor, financial and senior management, the internal audit activity, and the Board.
- Reviewing the Three-Year Business Plan and Annual Plan to assess progress toward specific goals and objectives.
- Ensuring equal opportunities to all entities who wish to participate in the CalPERS Investment programs and enterprise-wide procurement processes.
- Ensuring diversity among our business partners.
- Ensuring that an adequate system of risk evaluation exists in the organization.
- Ensuring Information Technology projects are a prudent investment of resources while meeting the business needs of the organization.

The Finance Committee will primarily fulfill these responsibilities by carrying out the activities enumerated below.

IV. AUDIT AUTHORITY AND RESPONSIBILITY

The Finance Committee shall have the following audit authority and responsibility:

A. General Audit Authority

1. To oversee audit assessments of internal administrative and accounting controls by both the external independent auditor employed by the Board, the real estate compliance auditor employed by the Board and by the

CalPERS internal auditors.

2. To serve as the primary liaison and provide the appropriate forum for handling all matters related to audits, examinations, investigations or inquiries of the State Auditor and other appropriate State or Federal agencies.

B. Independent External Financial Statement Auditor

1. To review the responses received to solicitations sent to auditing firms and to recommend the selection of the independent auditors to be engaged by the Board. This process occurs every five years under Government Code, Section 20228, which states that an auditor may not serve two consecutive terms.
2. To provide a forum which promotes independence of the external audit process. To review and to set standards for independence for the external auditor hired by CalPERS. These standards will meet or exceed those required by:
 - a. Federal and State laws and regulations,
 - b. Communications from the Public Accounting Oversight Board, and
 - c. Proposals by professional accounting and auditing organizations.

The CalPERS standards for independence are presented in Attachment A of this document.

3. To oversee CalPERS' annual financial statement audits and other audit-related services performed by the Board's external auditor and monitor the development of any recommended actions resulting from these audits.
4. To review the annual audited financial statements of CalPERS, required auditor communications, the external auditor's management letter, and any additional audit reports and other attest reports prepared by the Board's external auditor. To recommend appropriate action to the Board and CalPERS management.

C. Independent Real Estate Compliance Auditor

The independent real estate compliance auditor performs limited scope reviews and agreed-upon procedures to ensure contract compliance by CalPERS real estate general partners, advisors and property managers.

1. To review the responses received to solicitations sent to auditing firms and to recommend the selection of the real estate compliance auditor to be engaged by the Board.

2. To provide a forum which promotes independence of the real estate compliance audit process from investment management and investment general partners, advisors and property managers.
3. To oversee the periodic audits performed by the Board's real estate compliance auditor and monitor the development of any recommended actions resulting from these audits. To recommend appropriate action to the Board and CalPERS management.

D. Internal Audit Functions

1. To assure and maintain, through the organizational structure of CalPERS and by other means, the independence of the internal audit process.
2. To provide advice and recommendations to the Chief Executive Officer of CalPERS, including the assessment criteria to be utilized, in the engagement of the chief of the Audits Division or in any disengagement relation to this position.
3. To review and recommend adoption of the annual update of the biennial audit plan to the Board.
4. To oversee all contracted reviews, assessments, assurance reviews, and examinations required by the Board or requested by the Finance Committee. Assurance reviews include, but are not limited to auditing compliance with laws, rules, regulations, Board policies, internal controls, management operating procedures, and industry best practices.
5. Review internal audit reports and other periodic reports and presentations from CalPERS staff or as specified by management letters, and recommend appropriate action to the Board and CalPERS management.
6. To receive quarterly notices of the consulting activities performed by CalPERS' internal auditors.
7. To delegate management of the external financial statement auditor contract and the real estate compliance auditor contract to the Office of Audit Services. To designate the Office of Audit Services as the liaison for audits and examinations by the Bureau of State Audits and any other State or Federal auditors.

V. BUDGET AUTHORITY AND RESPONSIBILITY

The Finance Committee shall have the following budget authority and responsibility:

1. To participate in the strategic planning process.

2. To review annual policy plans to assure that resource requests are developed within constraints which include the resources available, what is important; the magnitude of change proposed; current economic conditions; and performance.
3. To evaluate funding alternatives and prioritization of programs and projects developed by the Board of Administration and other standing committees.
4. To review performance of activities to evaluate the need, effectiveness and efficiency.
5. To evaluate the plan for the fiscal year relative to goals for the year and modify and recommend approval of the annual budget to the Board.
6. To recommend performance indicators to measure or assess the relevant outputs, service levels, and outcomes of each activity.
7. To review the success in achieving the goals of the fiscal year.
8. To evaluate and act upon revisions to the current year budget, including budget change proposals (BCPs) recommended by the Chief Executive Officer.
9. To review periodic reports of CalPERS' operating expenditures and comparisons of performance with goals and objectives and recommend appropriate action to the Board and CalPERS management.
10. To assure and maintain, through the organizational structure of CalPERS and by other means, the independence of the budget review and evaluation process and to provide a forum which promotes communication to the public.
11. To maintain a system to share budget information with the appropriate state fiscal agencies and the Legislature, the Committee adopts a "two reading" process for requests to augment the budget. This process will insure that the Legislature, Control Agencies, members and other interested parties have an opportunity to provide input into the budget being recommended by this Committee. This process will allow all interested parties an opportunity to comment on the CalPERS budget.

VI. STRATEGIC PLANNING AUTHORITY AND RESPONSIBILITY

The Finance Committee shall have the following strategic planning authority and responsibility:

1. To determine the approach, direction, and roles for the ongoing strategic planning process.

2. To review the System's Three-Year Business Plan and Annual Plan to ensure that sufficient resources have been committed and sufficient progress is being made toward the accomplishment of strategic goals.
3. To review periodic assessments of political, economic, social, technological, and competitive changes to determine if revisions to the Strategic Plan are warranted.
4. To recommend to the Board revisions to the mission and strategic goals as identified through periodic assessments of the overall Strategic Plan.

VII. DIVERSITY AUTHORITY AND RESPONSIBILITY

The Finance Committee shall have the following authority and responsibility as it relates to diversity efforts:

1. To oversee and evaluate enterprise-wide internal and external Diversity Outreach initiatives.
2. To oversee and evaluate the annual Diversity Program Outreach communication plan to ensure effectiveness.
3. To review Diversity Outreach Program's Disabled Veteran's Business Enterprise reports periodically and the Small Business annual report to the Department of General Services and the Governor's office.

VIII. ENTERPRISE COMPLIANCE AUTHORITY AND RESPONSIBILITY

The Finance Committee shall have the following Enterprise Compliance authority and responsibility:

1. To ensure enterprise compliance functions are performed with independence and in accordance with professional standards.
2. To approve the annual enterprise compliance plan.
3. To review the status of the annual enterprise compliance plan and approve changes as needed.
4. To provide a forum promoting independence of the enterprise compliance process.

IX. INFORMATION TECHNOLOGY AUTHORITY AND RESPONSIBILITY

The Finance Committee shall have the following authority and responsibility for the projects they choose to monitor:

1. To review and monitor project scope, schedule, budget, and vendor selection of selected projects.

2. To ensure selected projects accomplish the objective defined in their proposals.

X. OTHER ADMINISTRATIVE SERVICES AUTHORITY AND RESPONSIBILITY

The Finance Committee shall have the following authority and responsibility related to administrative services:

1. To review the annual consulting and services contracts report.
2. To oversee operational issues and other administrative issues.

XI. COMMITTEE MEMBERSHIP

The Committee shall consist of seven (7) members appointed by the President of the Board. The Committee Chairperson and Vice-chairperson shall be elected annually by the members of the Committee. The Secretary to the Committee shall be designated by CalPERS Executive Staff.

XII. COMMITTEE ACTION

A quorum shall be the presence of a majority of the authorized members of the Committee. Action shall be by a vote of majority of the Committee, providing a quorum is present. All Committee actions shall be ratified by the Board to be effective.

XIII. COMMITTEE MEETING DATES

The Committee shall meet at least quarterly or as deemed necessary by the Committee Chair.

**CALIFORNIA PUBLIC EMPLOYEES' RETIREMENT SYSTEM (CalPERS)
FINANCE COMMITTEE CHARTER
ATTACHMENT A**

I. INDEPENDENCE

The purpose of this document is to define the standards of independence for the external auditor to be engaged by the CalPERS Board of Administration. These standards will meet or exceed those required by Federal and State laws and regulations, communications from the Public Accounting Oversight Board. These standards will also meet or exceed standards proposed by professional accounting and auditing organizations.

The external audit firm engaged to perform a financial audit and/or other audit services shall be independent in fact and appearance. The external audit firm engaged to perform the financial audit and/or other audit services shall not contemporaneously perform services that conflict with auditor independence. This policy statement is based on the principal that independence of the auditor is paramount to ensure objectivity and to express an unbiased opinion.

Therefore, this Attachment A describes the following:

1. Services that the external auditor is allowed to perform,
2. Services that the external auditor is not allowed to perform,
3. Finance Committee approval of services performed by external auditor,
4. Transition for existing consulting contracts held by the external auditor,
5. Avoidance of undue influence on the external auditor,
6. Rotation of audit firms, and
7. Disclosure reporting of external auditor services.

II. SERVICES THAT THE EXTERNAL AUDITOR IS ALLOWED TO PERFORM

The following items are within the scope of services that may be provided by the Board's independent financial statement auditor. In general, these services to be provided are those that are provided in the Statements of Auditing Standards and the Statements of Standards for Attestation Engagements promulgated by the Auditing Standards Board of the American Institute of Certified Public Accountants. The Finance Committee and the Board may make exceptions to these standards.

1. Annual financial statements audit,
2. Training,
3. Preparation of draft financial statements that are based on management's chart of accounts and trial balance and including any adjusting, correcting, and closing entries that have been approved by management,
4. Required communications,
5. Presentation of financial statement to the Finance Committee,
6. Attest services,

7. To make recommendations to management on internal control structure, risk management and/or accounting policies as a result of performing the other allowed services,
8. Provide basic accounting assistance, which is limited to services such as:
 - preparing draft notes to the financial statements based on information determined and approved by management,
 - preparing a trial balance based on management's chart of accounts, and
 - proposing adjusting and correcting entries that are identified during the audit so long as management makes the decision on accepting these entries.
9. Any other audit services approved by the Finance Committee and the Board that do not impair auditor independence.

III. SERVICES THAT THE EXTERNAL AUDITOR IS NOT ALLOWED TO PERFORM

The Board's independent financial statement auditor, its subsidiaries and affiliates, shall not perform the following services for CalPERS that the Board believes will impair auditor's independence while engaged to perform CalPERS' financial statement audit. These services include the following items:

1. Consulting,
2. Bookkeeping or other services related to the accounting records or financial statements of CalPERS,
3. Financial information systems design and implementation,
4. Appraisal or valuation services, fairness opinions, or contribution-in-kind reports,
5. Actuarial services,
6. Internal audit outsourcing services,
7. Management functions or human resources,
8. Broker or dealer, investment adviser, or investment banking services,
9. Legal services and expert services unrelated to the audit, and
10. Any other service that the CalPERS Finance Committee and Board determines, by policy, is impermissible.

IV. FINANCE COMMITTEE APPROVAL OF SERVICES BY THE EXTERNAL AUDITOR

The Finance Committee must approve all financial audit and other allowed services in advance of services being performed. The Finance Committee Chairman is responsible for pre-approval and shall inform the other committee members of pre-approval within 10 days, and this information shall be included in the next Finance Committee agenda. The Finance Committee may consult with chief of audit services when questions of independence arise.

Deminimus. No Finance Committee approval is required for additionally allowed services that last less than one month and cost less than \$10,000 per engagement. If aggregate total for services allowed exceeds 5% of the total amount of the financial statement audit contract, the Finance Committee or its delegate shall pre-approve the services.

V. TRANSITION

All services currently being provided by the external auditor that are not allowed shall conclude on or before June 30, 2003.

VI. UNDUE INFLUENCE

No member of the Finance Committee or CalPERS staff shall improperly influence the auditors or the firm engaged to perform audit services. Therefore, no person associated with CalPERS shall take any action to fraudulently influence, coerce, manipulate, or mislead the Board's independent financial statement auditor. To the contrary, persons associated with CalPERS shall promptly provide all information required for the auditor to form an opinion on CalPERS financial statements.

VII. ROTATION OF AUDIT FIRMS

Government Code, Section 20228 requires rotation of audit firms every five years. *Section 20228* reads as follows:

"The board shall annually employ a certified public accountant, who is not in public employment, to audit the financial statements of this system. The term for which the board may contract to employ a certified public accountant shall not exceed five years. The board shall not contract to employ the same certified public accountant for two consecutive five-year terms. The costs of the audit shall be paid from the income of the retirement fund. The audit shall be made annually. The board shall file a copy of the audit report with the Governor, the Secretary of the Senate, and the Chief Clerk of the Assembly. The board, for purposes of Section 7504, may file internally prepared financial statements with the Controller within six months of the end of the fiscal year, and shall file independently audited financial statements as soon as they are available. The audits shall not be duplicated by the Department of Finance or the State Auditor. This system shall be exempt from a pro rata general administrative charge for auditing."

VIII. DISCLOSURE REPORTING OF EXTERNAL AUDITOR SERVICES

A report of audit, attest and all other services allowed by this policy and provided by audit firms, including the fees paid to the auditor, shall be provided to the Finance Committee annually.